

A retailer's costs of doing business are not deductible from his gross receipts in calculating his Retailers' Occupation Tax liability. See 86 Ill. Adm. Code 130.410. (This is a PLR.)

August 31, 2005

Dear Xxxxx:

This letter is in response to your letter dated February 11, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to ABC for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither ABC nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

I am writing to request a binding Private Letter Ruling in accordance with 2 Ill. Adm. Code 1200.110 as to whether the charges for management services between ABC taxpayer, and XYZ, customer, are subject to the Illinois Retailer's Occupation Tax.

Background

ABC is a national distributor of plumbing, heating and air conditioning equipment, pipe, valves, fitting and other industrial products. ABC also provides integrated services to manufacturing companies.

The request involves our Integrated Services division. ABC has invested heavily in developing our expertise in this area. The Integrated Services division works with companies to reduce their maintenance and repair product costs, through inventory management expertise, technology advances, and labor productivity. The attached Exhibit II is a copy of our Internet marketing for the Integrated Services Division.

Facts

ABC has entered into a Integrated Services contract at an Illinois location with XYZ. The portions of the contract pertaining to compensation appear in Exhibit I. The contract stipulates that ABC will manage the supply room for indirect supplies for XYZ using our Integrated Services expertise. ABC will provide onsite employees to collect requisitions from the various departments within the customer's plant, The ABC employees then locate a supply source for the requisition, order the product, receive it, and deliver it within the plant. When appropriate the ABC employees will manage backup inventories for recurring and time critical products.

The compensation for this contract is provided in two ways. First, ABC bills the XYZ based on the cost of the product plus a markup called a 'Volume Fee'. ABC charges XYZ for the Illinois Retailer's Occupation Tax on the combined cost of the products plus the markup or Volume Fee unless the products qualify for an exemption.

Second, ABC also bills the customer a 'Management Fee'. The Management Fee is intended to compensate ABC for providing storeroom management services and expert systems to XYZ. This Fee is independent of the sale of the product, and it is reviewed annually. The Fee is based on the actual cost of providing the storeroom management services.

ABC believes the Management Fee represents a distinct and separate billing for labor and consulting and as such, the billings for the Management Fee are not subject to the Illinois Retailer's Occupation Tax as the Management Fee does not represent a retail sale under the Sec. 35 ILCS 120/1 as there is no transfer of ownership related to the charges for Management Fees. Such Management Fees do not vary based on the volume of product transferred between ABC and XYZ. Management Fees are charged based on the actual cost to provide storeroom management services.

'Sale at retail' means any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or byproduct of manufacturing.

'Sale at retail' shall be construed to include any transfer of the ownership of or title to tangible personal property to a purchaser, for use or consumption by any other person to whom such purchaser may transfer the tangible personal property without a valuable consideration, and to include any transfer, whether made for or without a valuable consideration, for resale in any form as tangible personal property unless made in compliance with Section 2c of this Act [35 ILCS 120/2c].

Request

Where as ABC and XYZ have entered into a contract whereby ABC will provide integrated services to XYZ, ABC respectfully requests confirmation through a binding Private Letter Ruling that the Management Fee addressed Section 5 (A) 1. of Exhibit I

does not represent a Sale at Retail under 35 ILCS 120/1 or Adm. Code Section 130.201 subject to the Illinois Retailer's Occupation Tax.

This request is for the tax periods beginning after July 1, 2003. Neither ABC taxpayer, nor XYZ, the customer, is currently under audit nor has received notice of a pending audit with respect to the transaction or this tax period.

To the best of my knowledge, the Department of Revenue has not previously ruled on this or a similar issue for or on behalf of ABC or its customer, XYZ, nor has the taxpayer submitted and withdrawn a similar request prior to receiving a ruling.

If you have any questions, please call me.

DEPARTMENT'S RESPONSE:

The Retailers' Occupation Tax is imposed upon persons engaged in this State in the business of selling tangible personal property for use or consumption. Retailers' Occupation Tax is based upon the "selling price" of the tangible personal property sold. Section 1 of the Retailers' Occupation Tax Act defines the term, "selling price," as the "consideration for a sale valued in money ... and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever...." See 35 ILCS 120/1. As indicated by this definition, a retailer's cost of doing business is not deductible from his or her gross receipts.

This principle is articulated in Section 130.410 of the Department's rules, enclosed. (86 Ill. Adm. Code 130.410) This rule states that in calculating Retailers' Occupation Tax liability, "labor or service costs" . . . "overhead costs" . . . "or any other expenses whatsoever" are not deductible from gross receipts. The rule provides that these costs of doing business are an element of the retailers' gross receipts subject to tax even if separately stated on the bill to the customer.

In addition, Section 130.450 (86 Ill. Adm. Code 130.450), enclosed, states that "[w]here the seller engages in the business of selling tangible personal property at retail, and such tangible personal property is installed or altered for the purchaser by the seller (or some other special service is performed for the purchaser by the seller with respect to such property), the gross receipts of the seller on account of his charges for such installation, alteration or other special service must be included in the receipts by which his Retailers' Occupation Tax liability is measured, if such installation, alteration or other special service charges are included in the selling price of the tangible personal property which is sold." This rule goes on to say that the fact that the special services are billed separately from the charge for the property sold does not change this result. Here, the storeroom management services fee (Management Fee) is billed separately from the integrated supply services fee (Volume Fee for the parts). Yet, all of these receipts reflect the cost to ABC to provide the parts to XYZ. This is evident from the further information provided by you in our telephone conversation. You indicated in that conversation that if a contract with a customer is for parts only and no storeroom management component is included, the parts costs would be higher. You stated that this is, in part, because of the increased overhead costs for ABC when there is no storeroom management arrangement.

Section 130.450 goes on to say that if the seller and the buyer agree on the special service charges separately from the selling price of the property, then those charges are excluded from Retailers' Occupation Tax. It is the Department's position, though, that simply stating the fees separately does not change the facts of the sale. In this instance, you have indicated that the

existence of the Management Fee reduces the contract price at which the parts are sold. That is because the Management Fee represents some of the overhead costs that ABC incurs in supplying the parts. These overhead costs are part of ABC's costs of doing business. In accordance with Section 130.410, it is the Department's position that the Management Fee is subject to Retailers' Occupation Tax as part of ABC's gross receipts for the sale of the parts supplied. The fact that this fee is billed separately does not, as indicated above, remove it from the purview of the Retailers' Occupation Tax.

The factual representations upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material factual representations as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Samuel J. Moore
Associate Counsel

Enc.